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IN THE

Supreme Court of the United States

No. 77-1325

M & M LEASING CORPORATION, et al.,
Petitioners,

v.

SEATTLE FIRST NATIONAL BANK, a National Bank,
et al.,
Respondents.

and

M & M LEASING CORPORATION, et al.,
Petitioners,

v.

PEOPLES NATIONAL BANK OF WASHINGTON, a National Bank
et al.,
Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

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CRAFTSMAN PRESS—WORD PROCESSING, SEATTLE

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IN THE
SUPREME COURT OF THE UNITED STATES

No. _____

M & M LEASING CORPORATION, et al.,
Petitioners,

v.

SEATTLE FIRST NATIONAL BANK, a National Bank,
et al.,
Respondents,

and

M & M LEASING CORPORATION, et al.,
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v.

PEOPLES NATIONAL BANK OF WASHINGTON, a National Bank
et al.,
Respondents,

PETITION FOR WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

Petitioners pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit entered on November 4, 1977 in this case.

OPINIONS BELOW

The opinion of the court of appeals is reported at 563 F.2d 1377 and is reprinted as Appendix A. The opinion of the district court is reported at 391 F. Supp. 1290 (W.D. Wash. 1975) and is reprinted as Appendix B.

JURISDICTION

The judgment of the court of appeals was entered on November 4, 1977. A petition for rehearing was filed on November 18, 1977. This petition was denied on December 23, 1977. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1). Jurisdiction of the District Court for the Western District of Washington was based upon 28 U.S.C. §§ 1331, 1361 and 2201-2202.

QUESTIONS PRESENTED[1]

A. Whether the leasing of automobiles, which essentially involves a merchandising function, can properly be conducted by national banks, as part of the "business of banking", under the National Bank Act.

B. Whether the involvement of national banks in the automobile leasing business is contrary to the federal policy and federal statutes requiring separation between banking and commerce.

STATUTE INVOLVED

The statute involved in this case is the National Bank Act, specifically Section 24, Seventh thereof, 12 U.S.C. § 24, Seventh. The administrative interpretations involved are 12 C.F.R. 7.3400 and 12 C.F.R. 7.7376. The complete

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[1] Petitioners are informed that certiorari will be sought shortly in National Automobile Dealers Association v. Board of Governors of the Federal Reserve System, __ F.2d __ (D.C. Cir. February 21, 1978). That case involves (a) the legality of automobile leasing by bank holding companies under the Bank Holding Company Act and (b) the impact of the Consumer Leasing Act of 1976 on automobile leasing by financial institutions. The issues raised in both of these cases are related and petitioners respectfully suggest that these cases will present the Court with a unique

statutory provisions and the administrative interpretations appear at Appendix C hereof.

The portion of 12 U.S.C. § 24 which governs this case is as follows:

> Upon duly making and filing articles of association and an organization certificate, a national banking association shall become . . . a body corporate, and as such, and in the manner designated in the organization certificate, it shall have power . . . .
>
> . . . .
>
> Seventh.
>
> To exercise by its board of directors or duly authorized officers or agents, subject to law, all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes according to the provisions of this chapter. . . .

STATEMENT OF THE CASE

Petitioners are independent leasing companies involved in the leasing of motor vehicles. In 1973, they filed suit in federal district court

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opportunity to review, at one time, the full range of important questions of federal law raised by the automobile leasing activities of financial institutions.

against the Comptroller of the Currency and two national banking associations, Seattle-First National Bank ("Sea-First") and Peoples National Bank ("Peoples"). The suit sought (a) an injunction against the automobile leasing activities of Sea-First and Peoples and (b) declaratory relief invalidating the interpretations of the Comptroller authorizing national banks to engage in the leasing of personal property, both on the ground that the leasing of automobiles was not a permissible activity for national banks under the National Bank Act.

The automobile leasing operations of Sea-First and Peoples are substantially similar. Both offer automobile leases on either an "open-end" or "closed-end" basis. In an open-end lease, the lessee guarantees the "residual value" of the vehicle at term end. ("Residual value" is the estimate of fair market value at term end made

by the lessor at lease inception.)[2] In a closed-end lease, the lessee assumes no responsibility or liability for residual value. This type of lease is sometimes referred to as a "walkaway" lease.

Both banks offer "direct" or "indirect" lease plans. Under the direct leasing plan, the bank deals directly with the lessee, i.e., the lessee approaches the bank lessor about entering a lease transaction, following which the bank purchases the desired automobile and leases it directly to the lessee. Under the indirect leasing method, the bank lessor enters into a master agreement with automobile dealers pursuant to which these dealers are authorized to offer the bank's lease plan at their respective business locations. All substantive provisions of leases

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[2] Residual value is a key feature in the typical lease transaction, as follows: The lessor establishes a capitalized cost for the vehicle (consisting of acquisition cost, financing cost and overhead and profit) from which is deducted the residual value and the typically small downpayment. The balance is divided by the number of months of the lease term, producing the monthly rental payment. Accuracy in residual value projection is a business must. An overly liberal estimate will result in loss to the lessor in a closed-end lease and to the lessee in an open-end lease.

entered into pursuant to this method are determined by the banks. The lease documents are prepared by the banks and furnished to participating dealers.

Under both the direct and indirect methods, the bank is the owner-lessor of the leased vehicle. Also, the lease agreements provide that, at term end, the leased vehicles are to be returned to the bank. The banks, as owners-lessors of leased automobiles, have the responsibility of disposing of vehicles returned to them at term end. They do so by either selling the vehicle to the lessee or a third party or re-leasing it.

Both banks advertise their automobile lease programs extensively, both to the general public and to bank customers. The record indicates that the great majority of lessees under the Sea-First and Peoples lease plans were not previous customers of the banks. The banks' leasing operations

are in direct competition with those of petitioners.[3]

At trial, petitioners contended that automobile leasing by national banks was ultra vires, being beyond the powers granted under the National Bank Act. In that regard, the petitioners relied principally on the fact that automobile leasing, by definition, involves the merchandising of automobiles, a commercial activity beyond the statutory powers granted to national banks. Specifically, an automobile lessor is directly involved in the purchase[4] and sale[5] of automobiles. Additionally the bank lessor, like any other automobile lessor, must possess a proficiency in estimating residual value, a business

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[3] The growth of these leasing operations has been dramatic. Sea-First began leasing motor vehicles in 1973 and, at present, has over 2000 automobiles leased. Peoples commenced leasing operations in 1972 and, at the time of trial, had approximately 1800 vehicles under lease.

[4] This is particularly true in the case of the "direct" leasing plans of Sea-First and Peoples.

[5] Being the owner of a leased vehicle, the bank lessor has the ultimate contractual responsibility for disposal thereof at term end.

trait more related to automobile merchandising than it is to banking activity.

The district court ruled that "open-end" leasing was a permissible activity for national banks, being in the court's view, directly related to the express powers granted under the National Bank Act of "loaning money on personal security" (with respect to "direct" leases) and "discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt" (with respect to "indirect" leases). 391 F. Supp. at 1296. On the other hand, the district court held that closed-end leases, where the bank's financial return "depends to any extent upon the residual value of the leased property", was not part of the statutorily authorized "business of banking" and, therefore, illegal. Ibid. The district court's rationale for this distinction related to the loss exposure of the national banks. It reasoned that, in open-end leases, the lessee's guarantee of residual value protected the bank against a downward fluctuation in term-end value

of the leased vehicle while, in the closed-end situation, the bank assumed the risk of decline in value and thereby "entered the realm of speculative ventures". Id. at 1295-96.

The court of appeals, by 2-1 majority, affirmed the district court on the issue of open-end leasing. 563 F.2d at 1379. The majority opinion held, however, that the district court's ruling on closed-end leasing was overly restrictive (563 F.2d at 1380), finding that it was unnecessary for a national bank lessor to "recover during the initial lease term every penny of the cost of the leased property plus its financing costs." 563 F.2d at 1380. The majority opinion reasoned, interchangeably, that automobile leasing was a permissible activity "when, in the light of all relevant circumstances, the transactions constitute the loan of money secured by the properties leased" (563 F.2d at 1380, or when "the residual value of the

leased property at the expiration of the lease contributes insubstantially to the bank's recovery of its advances plus interest." 563 F.2d at 1384.

Somewhat inconsistently, the majority first ruled that a permissible bank leasing transaction could include re-leasing of the vehicle[6] but later held that national banks could not engage in the "short-term car rental business", nor could they engage in a leasing transaction "which from its inception inevitably must be repeated or extended to enable the bank to recover its advances plus profit." 563 F.2d at 1384.

The dissenting judge recognized that automobile leasing draws a bank lessor "ineluctably into the business of disposing of used chattels -- not in pursuit of the lender's traditional remedy of foreclosure and sale incident to the borrower's default -- but pursuant to the terms of the lease agreement itself." He concluded there-

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[6] See, e.g., the statement that it was unnecessary that the bank recover its investment "during the initial term." 563 F.2d at 1380. See also, 563 F.2d at 1381, where the majority discussed releasing as a permissible term-end disposal method.

from that this "resultant preordained participation of national banks in the market disposition of personal property is neither a part of the "business of banking nor an incident thereto", and was therefore unauthorized and illegal. 563 F.2d at 1385.

REASONS FOR GRANTING THE WRIT

The Ninth Circuit has decided a question of federal law which has a significant impact upon our nation's economy and the role that financial institutions, in this case national banks, will play therein. The issues presented have not yet been, but should be, addressed by this Court.

A. This Case is One of First Impression, Involving an Important Question of Federal Law, Which Should Be Resolved by This Court

1. Case of first impression

Prior to the instant case, no federal or state court at any level had considered the legality of automobile leasing by national banks.[7] The federal courts have considered the legality of national banks' conducting other businesses.

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[7] The dissenting court of appeals judg referred to this as a "judicially uncharted" field. 563 F.2d at 1384.

Several of these decisions are referred to in Paragraph B, infra.

This case presents an excellent opportunity for this Court to consider the specific question of whether or not the National Bank Act prohibits national banks from engaging in the business of automobile leasing. The present controversy is perhaps the only time meaningful consideration of this issue can be had. Automobile leasing by national banks was virtually nonexistent ten years ago. This industry has grown tremendously during the 1970s, primarily because of the manner in which some national banks have utilized their market advantage (i.e., tremendous financial resouces) to dominate the field.[8] Deferring review of the issues presented will render them academic because of the reasonable probability of full-scale entry by national banks into the

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[8] For example, in the instant case, Sea-First is the largest and most dominant bank in Washington; it has over $5.3 billion in assets and 166 banking offices in Washington. Peoples has $966 million in assets and 65 banking offices. Both banks dwarf the petitioners, singly or as a group.

leasing business should the Ninth Circuit's decision be allowed to stand.

Such a full-scale entry and the accompanying entrenchment of national banks might create a practical obstacle to a full on-the-merits consideration of this question by this Court at a later time. Indeed, the accelerating pace at which financial institutions, particularly national banks, are entering the automobile leasing business strongly suggests the need for review at this time.

2. Important question of federal law

The decision sought to be reviewed impacts nationally. The trial record demonstrates that automobile leasing is projected to become a major factor in automobile merchandising over the next

few years.[9] The trial record further demonstrates a dramatic increase in the involvement of financial institutions, particularly national banks, in automobile leasing over the last decade. For example, the majority opinion of the court of appeals noted "that today over 1000 national banks are engaged in the leasing of personal property which has an aggregate value in excess of $2 billion." 563 F.2d at 1382.[10]

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[9] The Federal Reserve Board has also found as follows:

> Total automobile leasing including commercial fleet leasing in 1974 was 2.8 million vehicles, about 26 per cent of new car production. Some projections indicate that this rate of growth will continue and that by 1980, 40 per cent of new car registrations will be for leased automobiles.

41 Fed. Reg. 45977 (1976).

[10] More specifically, the Federal Reserve Board has found as follows:

> In 1968 there were 267 national banks engaged in auto leasing; by 1974 the number rose to 590 national banks . . . . It appears that the number of banks involved in automobile leasing is continuing to grow.

41 Fed. Reg. at 45978.

Furthermore, the Seafirst Corporation 1977 Annual Report provides the following information at page 25:

Given these factors, the importance of the issue raised by the instant case can readily be perceived. There exists a federal policy of long standing "which strictly limits banks to banking." See Arnold Tours, Inc. v. Camp, 400 U.S. 45, 46 n. 4 (1970).[11] This policy is reflected in the carefully delimited powers granted to national banks under the National Bank Act and the several decisions of this Court and others restricting national banks to their only permissible field of activity, the "business of banking." The decision of the court of appeals

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Leases - Total lease financing averaged $162 million, up 66 percent from 1976. Lease financing has registered strong growth over the last several years. There are two major components of the lease portfolio: auto leases, and equipment leases for larger business-oriented capital equipment. Auto leases totalled $94 million and equipment leases were $119 million of the total of $213 million at year-end of lease financing.

For a more detailed analysis of this growth, see Appendix D.

[11] See also H.R. Rep. No. 91-1747, 91st Cong., 2d Sess. 11-12 (1970) which contains excerpts of a Presidential message indicating concern over the disturbing trend toward erosion of the traditional separation between banking and commerce.

that the "business of banking" encompasses automobile leasing, a business activity having definite commercial, rather than financial, overtones, is at variance with that policy. The properly limited role of national banks in the national economy is of paramount public policy importance. A determination of what that role should be is a matter uniquely appropriate for resolution by this Court.

B. The Decision of the Court of Appeals Represents a Departure From the Long Line of Federal Cases Rigidly Enforcing the Line of Demarcation Between Banking and Commerce

The decision of the court of appeals permits national banks to engage in a business which petitioners contend, and which the dissent recognizes, necessarily involves the bank in the merchandising of automobiles. Whether or not this holding constitutes a departure from a long line of federal cases rigidly enforcing the line of demarcation between banking and commerce is an issue which this Court should decide.

There are many cases holding that national banks are corporations of limited powers. First National Bank v. Missouri 263 U.S. 640, 656-57 (1924); Bullard v. Bank, 85 U.S. (18 Wall.) 589, 593 (1874). These limited powers are those contained either expressly or impliedly in the National Bank Act, 12 U.S.C.A. § 24. In discussing national bank powers in Barron v. McKinnon, 196 F. 933 (1st Cir. 1912) the court stated:

> It is also settled that the statutes of the United States constitute the measure of the authority of such corporations, and that they cannot rightfully exercise any powers except those expressly granted, or which are incidental thereto.

A corollary to this general rule is the series of decisions holding that powers not conferred by the statutory grant are deemed denied. The principle was in Barron v. McKinnon, supra, stated as follows:

> National banks are not organized for the purpose of trading or speculating in stocks and while this power is not expressly prohibited, such a prohibition is implied by the failure to grant the power.

196 F. at 937. This interpretation of the powers of national banks finds full support in the decisions of the Supreme Court and other federal courts. See, Texas & P. Ry. v. Pottorff, 291 U.S. 245, 253 (1934); Concord First National Bank v. Hawkins, 174 U.S. 364, 366-367 (1899); Yonkers v. Downey, 309 U.S. 590, 596 (1940); Saxon v. Georgia Ass'n of Independent Ins. Agents, Inc., 399 F.2d 1010, 1014 (5th Cir. 1968). Moreover, there are numerous cases holding that a national bank has authority to conduct a business only where the sole purpose for so doing is the recoupment of losses. Birdsell Manufacturing Co. v. Anderson, 104 F.2d 340 (6th Cir. 1939); Atherton v. Anderson, 86 F.2d 518 (6th Cir. 1936), rev'd on other grounds, 302 U.S. 643 (1937).

The decision of the court of appeals greatly expands the statutory concept of what is the "business of banking" by permitting national banks to engage in the leasing business. By the very nature of leasing, banks at the end of the lease will come into possession of the leased item,

the motor vehicle.[12] At that time the banks must sell or otherwise dispose of the vehicle. Most significantly, this disposal responsibility is a matter of contractual obligation, not an incident of "the orderly liquidation of the bank's security", as posited by the majority opinion.[13] This "resultant preordained participation in the market disposition of personal property"[14] constitutes nothing less than a merchandising activity.

The instant decision represents such a significant departure from precedent and the underlying national policy as to warrant review by this Court.

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12 Additionally, when engaging in direct leasing the bank lessor necessarily becomes a commercial purchaser of automobiles.

13 563 F.2d at 1383.

14 563 F.2d at 1385.

C. The Decisions of the Court of Appeals Is Clearly Erroneous

1. The facts

The majority decision erroneously construes the transaction as a loan of money only for the purpose of the National Bank Act while acknowledging that for all other purposes, including Internal Revenue Service purposes (with all of its tax advantages), it is a lease. This distinction has never been made previously by any other court, state or federal.

The following, stated as facts by the court of appeals, are not substantiated by the record. The court incorrectly states that motor vehicle leases usually, but not invariably, are "generated by automobile dealers." It is inaccurate to state that the leases are generated by automobile dealers in view of the substantial advertising campaigns conducted by both banks. Further, the record shows that the major terms of the lease transaction are fashioned by the bank rather than the petitioners. Only the make,

model and accessories are left to the leasing companies. The time and payment schedule, as well as residual value, are all predetermined according to the manual of each bank.

The record shows that the banks are engaged in merchandising automobiles from start to finish. The banks herein have facilities separate and apart from their banking operations wherein the leasing operation is conducted. Moreover, the banks advertise their leasing activities heavily to the consuming public and carefully advertise that the customer is leasing rather than borrowing.

2. The law

The basic misapprehension of the majority opinion in the instant case is its equation of the disposal of leased vehicles at term end with the liquidation of collateral security.[15] The majority views this as some form of incidental activity

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15 It is significant also that the majority nowhere articulated its rationale for the proposition that the large-scale purchasing of automobiles (as in "direct" leasing operations) is part of the "business of banking."

when, in fact, it is an integral part of an automobile leasing operation. Full realization on the residual value projection is essential to business success in the automobile leasing field. It constitutes as well the final economic step in the leasing transaction. Due appreciation of that fact refutes the "incidental" characterization of the disposal activity and the basic decisional premise of the court of appeals.

Additionally, the instant decision suffers from internal inconsistencies and a lack of definitiveness, both of which deficiencies militate against the decision serving as a reliable guide for future action. First, the majority opinion, at one and the same time, recognizes re-leasing of vehicles at term end as a proper disposal tool[16] yet holds that a lease which is based on an anticipated renewal or re-lease is not permissible.[17] Secondly, the majority opinion holds that closed-end leases are not per se impermissible and

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16 563 F.2d at 1380, 1381.

17 563 F.2d at 1383.

that it is not necessary for the bank lessor to recover its investment within the initial term.[18] On the other hand, the majority opinion holds that a closed-end lease is permissible only where the residual value "contributes insubstantially to the bank's recovery of its advances plus interest."[19]

The majority opinion candidly admits that it does not provide a "comprehensive charter" for future guidance.[20] In this respect, the majority proposes that the Comptroller develop the necessary guidelines. Without commenting on the appropriateness of such a delegation, petitioners respectfully suggest that this function should not be passed on to the Comptroller. Petitioners further suggest that the historical record clearly shows that the Comptroller has demonstrated in the

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18 563 F.2d at 1380. This holding raises the question of whether the bank lessor in such an instance is speculating on the resale value of the leased automobile and, if so, whether this is properly the "business of banking."

19 563 F.2d at 1384.

20 Ibid.

past an inability or unwillingness to interpret the National Bank Act properly. The historical record also shows that specific direction and, all too often, corrective action, has been required of the courts.[21]

In short, this case, more than the usual one, requires a definitive and explicit ruling. This the decision of the court of appeals does not provide. Petitioners submit that the important matters subsumed in this case require the Court's attention.

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21 See, e.g., the court's notation in Arnold Tours, Inc. v. Camp, 472 F.2d 427, 435-36 n. 12 (1st Cir. 1972) as to the Comptroller's singular lack of success in obtaining judicial approval of his interpretive rulings. Since then, still another of the Comptroller's interpretations has been rejected. National Retailers Corp. v. Valley National Bank, 411 F. Supp. 308 (D. Ariz. 1976). In fact, this case represents the only instance where one of the Comptroller's rulings has been upheld.

CONCLUSION

For the foregoing reasons, the petition for writ of certiorari should be granted.

Dated March 17, 1978.

Respectfully submitted,

LYCETTE, DIAMOND & SYLVESTER
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Counsel for Petitioners

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

M & M LEASING CORPORATION; GOODWAY LEASING, INC.; BILL PIERRE LEASING, INC.; BUDGET RENT-A-CAR OF WASHINGTON-OREGON,
Plaintiffs-Appellants,

v.

SEATTLE FIRST NATIONAL BANK, a National Bank; FIRSTBANK LEASING CORPORATION, a Washington corporation; JAMES E. SMITH, Comptroller of the Currency of the United States,
Defendants-Appellees.

NO. 75-2576

OPINION

M & M LEASING CORPORATION; GOODWAY LEASING, INC.; BILL PIERRE LEASING, INC.; BUDGET RENT-A-CAR OF WASHINGTON-OREGON,
Plaintiffs-Appellees,

v.

PEOPLES NATIONAL BANK OF WASHINGTON, a National Bank; PEOPLES LEASING COMPANY, a Washington corporation; JAMES E. SMITH, Comptroller of the Currency of the United States,
Defendants-Appellants,

JAMES E. SMITH, Comptroller of the Currency of the United States,
Defendant-Cross-Appellant.

NO. 75-2577

Appeal from the United States District Court
for the Western District of Washington

BEFORE: KOELSCH and SNEED, Circuit Judges, and RICHEY,* District Judge.

SNEED, Circuit Judge:

Appellees, Seattle First National Bank (Seafirst) and Peoples National Bank of Washington, are engaged in the leasing of motor vehicles and other personal property. Appellants, M & M Leasing Corporation, Goodway Leasing, Inc., Bill Pierre Leasing, Inc., and Budget Rent-A-Car of Washington-Oregon, Inc., are independent corporations engaged principally in motor vehicle leasing. Defendant-cross-appellant is the Comptroller of Currency of the Unted States.

Appellants, plaintiffs in the trial court, sought a declaration that the appellees' leasing of motor vehicles and other personal property was not authorized by 12 U.S.C. § 24, Seventh,[1] despite the fact that it is sanctioned by the Comptroller of the Currency.[2] Appellants also requested an injunction barring appellees and their subsidiaries from further motor vehicle leasing activities. Moreover, appellant asserted that, even if the Comptroller's rulings relied upon to sanction appellees' activities are valid, such activities exceeded the authorization the rulings provided and should be enjoined to that extent.

The trial court in an able opinion distinguished between motor vehicle lease transactions in which the banks do not assume the risk of residual value fluctuation upon termination of the lease (so-called "open end" leases) and those in which the banks do assume such risk (so-called "closed end" leases). In its initial judgment

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* Honorable Mary Anne Richey, United States District Judge, for the District of Arizona, sitting by designation.

the trial court enjoined the appellees "from engaging in, motor vehicle lease transactions in which the banks assume the risk of residual value fluctuation upon termination of the lease" (II C.R. 575) and declared the Comptroller's interpretive rulings, 12 CFR §§ 7.3400 and 7.7376, invalid to the extent they authorized such leases.

None of the parties was entirely satisfied by this disposition of their dispute. The appellee banks moved to clarify the opinion and judgment to remove "closed end" leases in which there is to be a "full payout" prior to termination of the lease from the scope of the trial court's injunction and to delete the words "motor vehicle" from the language of the injunction. The appellants thought the court's injunction should embrace all leasing and the Comptroller of Currency indicated displeasure with the restrictiveness of the trial court's opinion and injunction.

The trial court in due course amended its injunction to delete the words "motor vehicle" so that it currently reads "from engaging in lease transactions in which the banks assume the risk of residual value fluctuation upon termination of the lease." (II C.R. 598). Also, by order, the trial court construed its opinion and judgment as follows:

> "Lease transactions in which the lessor bank, during the initial lease term, is repaid the cost of the property leased plus the cost of financing the transaction, in the form of rentals, tax benefits and/or the guarantee of a financially responsible guarantor, are neither disapproved in the Court's opinion nor enjoined by the judgment entered herein." (II C.R. 596).

These modifications satisfied the appellees but, of course, neither the appellants nor the

Comptroller. Hence, this appeal was taken by them. We affirm in part and reverse in part.

In essence, we view the trial court's holding as correct, so far as it goes, but somewhat more restrictive than the law requires. As we see it, the "business of banking," which 12 U.S.C. § 24, Seventh, authorizes the appellees to conduct, includes leases of personal property when, in the light of all relevant circumstances, the transactions constitute the loan of money secured by the properties leased. A transaction may be so characterized, in our opinion, even if it is designed so that the lessor bank does not recover during the initial lease term every penny of the cost of the leased property plus its financing costs. A lease ceases to be a secured loan when the lessor assumes material burdens other than those of a lender of money and is subject to significant risks not ordinarily incident to a secured loan. The bright line traced by the trial court provides a sound guide by which leases can be kept within the scope of the "business of banking." We are not, however, prepared to say that the trial court's bright line constitutes the precise outer limit of the "business of banking."

To support our holding, we first will describe the nature and scope of national banks' involvement in the leasing of personal property, we will next analyze the term "business of banking" and apply the analysis to such leasing, and, finally, we will identify some of the characteristics of leases which lie beyond the outer limits of the "business of banking."

I

Leasing By National Banks

The record of this case indicates that the role of national banks, such as Seafirst and Peoples, in personal property leasing generally

is essentially that of a financing agency. To illustrate this it is useful to divide personal property leases into motor vehicle leases and leases of aircraft, ships and other so-called "big ticket" items.

Motor vehicle leases usually, but not invariably, are generated by automobile dealers. Particular dealers will enter into an agreement with a bank under which dealers will lease automobiles to their customers. The major terms of a lease, i.e., make, model, accessories, term, and payment schedule, are fashioned by the dealer in a manner that fits his and the customer's interests and conforms to the lease design envisioned by the dealer's arrangement with the bank. To protect itself against improvident leases the bank possesses the right to review both the substantive terms of a lease and the credit-worthiness of the lessee before accepting the lease. The crucial items reviewed are the credit rating of the customer and the vehicle's residual value. Upon accepting the lease the lessee-customer is notified and instructed to make lease payments to the bank. The title of the vehicle shows the bank as the legal owner while the customer is listed as registered owner and lessee. Customers who approach the bank initially are usually referred to dealers with whom the bank has leasing arrangements.

The bank functions somewhat differently with respect to "big ticket" items. With respect to them, generally the customer calls the bank directly and expresses an interest in leasing particular personal property. This contact essentially is to inquire about the availability of credit. The bank performs no procurement function. The customer chooses the property he wishes to lease, selects a vendor and negotiates with him the terms of the purchase. Assuming the bank finds the customer an acceptable credit risk, it

then purchases the property and leases it to the customer. Delivery by the seller is made directly to the customer-lessee who makes the lease payments to the bank.

Both motor vehicle leases and "big ticket" leases provide that the burdens of operating costs and risks are borne by the lessee. Thus, the lessee agrees to purchase insurance sufficient to cover the bank's interest, pay all repairs and maintenance, and assume the risk of loss or damage.

Motor vehicle leases and "big ticket" leases frequently differ, however, in certain important respects. Foremost is the differences in the lessee's responsibility at the expiration of the initial term of the lease. Motor vehicle leases, for example, include a guarantee by the lessee that the vehicle will have a certain residual value at the expiration of the usual two or three year term.

This residual value is simply the anticipated resale value of the vehicle at the lease's termination. Should resale value in fact be less than the guaranteed residual value, the lessee must pay the difference. Should it be more, the excess when realized is refunded to the lessee. "Big ticket" item leases, on the other hand, normally impose no residual value guarantee on the lessees. The need for such guarantees is reduced, if not eliminated, by the fact that such leases typically are for a term which approximates the economic life of the properties. Leases in which there is a residual value guarantee are designated, in the language of commerce, as "open end" leases, while those in which no such guarantee exists are designated "closed end" leases.

Closed end leases, therefore, do impose on the lessor bank a risk not borne in the case of open end leases. In the former the lessor bank must absorb any difference between the estimated

residual value at the end of the lease and a lesser actual resale price. In the open end lease, on the other hand, any such difference is guaranteed by the lessee. It is this distinction between the two types of lease that, as already noted, strongly influenced the trial court's disposition of this case.

Notwithstanding this difference between open end and closed end leases, the lessor bank under each type of lease realizes on the property at the expiration of the lease in a substantially similar manner. Thus, at the lease's end the lessor bank will dispose of the property in the simplest possible mannèr. Should the lessee not purchase the item, either for the estimated residual value or for a mutually agreeable price, the lessor bank will dispose of it by sale or by way of a new lease. Motor vehicles not sold to the lessee, for example, are either resold to the dealer, sold in the wholesale market, or leased to another customer. Moreover, the record of this case does not reveal that closed end leases as a class impose significantly more onerous economic burdens on banks than do open end leases. This is not surprising because leases of "big ticket" items, leased under closed end terms, generally provide for the bank's investment plus interest to be returned by way of lease payments prior to the expiration of the lease.

From the standpoint of a bank the advantages of leasing, as opposed to traditional lending on chattel security, are said to be numerous. Certain tax benefits pertaining to depreciation and the investment tax credit are said to be available under leasing but not under lending. Leasing, it is pointed out in the record of this case, permits the avoidance of usury laws and increases the demand for credit by eliminating the need for down payments by the customer.

Lessees also may derive advantages from leasing not available when conventional borrowing is employed. A lease obligation may be reflected on the balance sheet more favorably than an indebtedness, and leasing may permit avoidance of limitations on the lessee's ability to borrow. See Stiles & Walker, Leveraged Lease Financing of Capital Equipment, 28 Bus. Lawyer 161 (1972).

In any event, leasing yields to the banks a rate of return that compares favorably to that of lending. A portfolio of prudently-arranged leases imposes no greater risks than one of equally prudently-arranged loans. It is small wonder, therefore, that today over 1000 national banks are engaged in the leasing of personal property which has an aggregate value of in excess of $2 billion.[3] Thus, although much of this growth has occurred in the 1970's and resulted from the entrance of national banks into the field of motor vehicle leasing, it is clear that leasing at present is a significant part of the business of national banks.

II

The "Business of Banking"

While the importance of leasing to the business of national banks is relevant to determining the extent to which such activity is useful and convenient, it does not alone establish that leasing is within the "business of banking" as authorized by 12 U.S.C. § 24, Seventh. In construing the scope of the authority established by this statutory provision we adopt the approach employed by the First Circuit in Arnold Tours, Inc. v. Camp, 472 F.2d 427, 431-32 (1st Cir. 1972). That is, for an activity to be pursuant to an incidental power "necessary to carry on the business of banking" it must be "convenient or useful in connection with the performance of one of the bank's

established activities pursuant to its express powers under the National Bank Act." Id. at 432. Thus, leasing must be convenient or useful to business expressly authorized by 12 U.S.C. § 24, Seventh. As indicatged above, we hold that leasing, when in the light of all relevant circumstances the transaction constitutes a loan of money secured by the leased property, see p. 2, is incidental to the "loan of money on personal security," an activity expressly authorized by the National Bank Act.

In reaching this conclusion we draw comfort from the fact that commentators uniformly have recognized that the National Bank Act did not freeze the practices of national banks in their nineteenth century forms. Indeed, many contend that the powers of national banks "are not confined to the powers specified in the National Bank Act and those necessary to carry out those specific powers." Trimble, The Implied Power of National Banks to Issue Letters of Credit and Accept Bills, 58 Yale L.J. 713, 721 (1949). See Huck, What Is the Banking Business?, 21 Bus. Lawyer 537, 541 (1966); Note, Diversification by National Banks, 21 Stan. L. Rev. 650, 651-53 (1969). We prefer, however, the Arnold Tours Inc. formulation of the scope of "incidental" powers; but, whatever the scope of such powers may be, we believe the powers of national banks must be construed so as to permit the use of new ways of conducting the very old business of banking. Those who would reject such new ways should recall that Chief Justice Holt's efforts in Clerke v. Martin, 2 Ld. Raym. 757 (1702) to deny the negotiability of promissory notes payable to a named payee or order was overturned by statute several years later. 3, 4 Anne c. 9 (1704). As Holdsworth put it, Chief Justice Holt's mistake was to believe that "the most correct technical reasoning could stop the development of the new machinery rendered necessary by the new needs of an expanding trade." Holdsworth, History of the English Law VIII, 175-76 (1926). Unless compelled by higher authority, which we would then

believe to be misguided, we do not wish in the context of this case to repeat Chief Justice Holt's mistake.

Appellants would have us follow in Holt's footsteps by emphasizing that secured lending to permit the acquisition of property can be accomplished through traditional forms. A loan secured by a chattel mortgage or a conditional sales contract provides the proper means, they insist, by which a "loan of money on personal security" ought to be accomplished. A lease which serves the same purpose is impermissible. Particularly is this true, they assert, when both the lessor bank and the lessee customer distinguish the lease from a loan and third parties, including various government agencies, treat the two quite differently.

Appellants are correct in stating that functionally interchangeable leases and secured loans are regarded as distinct in both the rhetoric and regulation of this form of commerce. However, it is their functional interchangeability that is the touchstone of our decision. To ignore that in the interpretation of 12 U.S.C. § 24, Seventh, is figuratively to reject, as did Chief Justice Holt, something "invented in Lombard Street." Clerke v. Martin, supra. Whether third parties in other contexts should treat leases that are equivalent to loans as nonetheless distinct and separate is not at present before us. Whatever might be the proper dispositions of such issues, they should not influence our opinion in this case.

III

The Limits of the "Business of Banking"

It should be clear that our holding is not without limits. It does not embrace the view that national banks may compete with appellants

in the daily or short-term car rental business. Nor does it permit national banks to become self-financing automobile dealers, utilizing their unique position to acquire an inventory of automobiles at advantageous prices to lease at going market rates to customers. Neither activity is a means by which a bank makes a "loan of money on personal security." Each is a business distinct from banking.

A national bank also leaves the business of banking when it undertakes, as a "service" to its customers, to pass on to them any price reductions which its marketing power can extract from sellers of automobiles or other personal property. There may be a place for a "buyer's cooperative" in automobile marketing, but that place is not in a national bank. Such a cooperative, whether in substance or in form, is not the business of banking.

It is also clear that national banks cannot provide operational services such as repairs, maintenance, spare parts, insurance coverage, license renewals, etc. Such services are not those of a bank.[4] This proscription shapes the duration of a lease that a national bank properly can employ. Short term leases which inescapably thrust upon the bank significant service responsibilities impose non-banking responsibilities. As previously indicated, leases of automobiles for two or three years do not necessarily entail non-banking responsibilities;[5] and, of course, a lease for the economic life of the property also does not.

Proscribed operational services, also, do not include the functions incident to the disposal of the property at the expiration of the lease as described at p. 7 of this opinion. So long as these activities constitute only the orderly liquidation of the bank's security they remain within the business of banking.

Finally, our holding manifestly is not intended to authorize leases which impose significant financial risks on national banks more onerous than those incident to loans. Therefore, it is necessary that the lessor bank look primarily to the obligations of the lessee for the entire return of its advances. It is the lessee's credit worthiness, not primarily the market value of the leased property, to which the bank must look for its return. No banker, however, ignores the borrower's collateral; nor must he when the loan is cast in lease form. Our point, put differently, is that a lease, which from its inception inevitably must be repeated or extended to enable the bank to recover its advances plus profit, is not a "loan of money on personal security." Such leases indicate a rental business, not the business of banking. To engage in the business of renting personal property would permit the assumption of risks not permitted national banks. An impermissible assumption of risks is not indicated, however, either by an open end lease, in which the bank's entire advance is guaranteed by the lessee, or a closed end lease, in which the residual value of the leased property at the expiration of the lease contributes insubstantially to the bank's recovery of its advances plus interest.

IV

Role of the Comptrollers

We recognize our observations do not provide a comprehensive charter by which the appellee banks may guide their steps. For example, we have not dealt with the type of advertising that is compatible with leasing activities of national banks that are within their statutory authority. Nor do we comment on the appropriateness of a subsidiary of a national bank acquiring a dealer's license from the state and maintaining a garage for storing previously leased automobiles.

Preparation of a comprehensive charter is a function that belongs to the Comptroller. It is his duty to promulgate reasonably detailed regulations which will confine leasing within the channels of the "business of banking." We do not believe that 12 C.F.R. §§ 7.3400 and 7.7376 adequately perform this duty.

Our present contribution merely sketches the boundaries of the business of banking and resolves the particular controversy before us.

We affirm in part and reverse in part and remand for such modifications of the trial court's judgment as is required by this opinion.

Costs shall be borne by the appellants.

Affirmed in part, Reversed in part.

FOOTNOTES

[1] The pertinent portion of 12 U.S.C. § 24 (Seventh) is as follows:

> "To exercise by its board of directors or duly authorized officers or agents, subject to law, all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, bills of exchange, and other evidence of debt; by receiving deposits; by buying and selling exchange, coin and bullion; by loaning money on personal property; and by obtaining, issuing, and circulating notes according to the provisions of this chapter . . . ."

[2] The authorization appears in 12 C.F.R. § 7.3400 and is as follows:

> "A national bank may become the owner or lessor of personal property acquired upon the specific request and for the use of a customer and may incur such additional obligations as may be incident to becoming an owner and lessor of such property. Lease transactions do not result in obligations for the purpose of 12 U.S.C. 84. Since the lease payments are in the nature of rent rather than interest, 12 U.S.C. 85 and 86 are not applicable."

12 C.F.R. § 7.7376 authorizes an operating subsidiary of a national bank to "lease property."

[3] These figures appear in the appellee banks' brief p. 46 and are derived from a survey introduced at the trial made by the Comptroller of Currency.

[4] See, Automobile Leasing as an Activity for Bank Holding Companies, Fed. Reserve Bull., Nov. 1976, 930, 935.

[5] In describing leases which are equivalent to secured loans, it has been said:

> In each case there is a sum certain in amount. This sum includes the acquisition cost of the vehicle and the cost of a financing and is recovered through a series of noncancellable deferred payments. The term of the payment period in both cases is 24 to 36, or recently to 48 months. The vehicle serves as a type of collateral to guarantee payment on both the installment loan and the lease. Both forms of financing are applied to a specific automobile that is chosen prior to preparation of the doccument . . . . All attributes of ownership pass to the lessee who is responsible for servicing, insurance, and depreciation.
>
> [The banks] use the same skills in leasing a vehicle as they do in financing it through an installment loan.

Automobile Leasing as an Activity for Bank Holding Companies, supra n. 4.

M & M LEASING CORPORATION, et al., v. SEATTLE FIRST NATIONAL BANK, et al., Nos. 75-2576, 75-2577

KOELSCH, Circuit Judge, concurring in part, dissenting in part:

I concur in much of Judge Sneed's able effort to introduce a degree of coherence into the rapidly developing (and judically uncharted) field of bank "lease financing." Shorn of the "language of commerce," I understand the majority to sanction two forms of lease transactions that may permissibly be engaged in by national banks under section 24 (Seventh) of the National Bank Act (12 U.S.C. § 24 (Seventh): either the bank as lessor recovers all of its investment and profit in the form of rental payments from the lessee over a lease term spanning the substantial economic life of the chattel or, at the expiration of a lease term less than that of the approximate economic life of the asset, looks to the lessee to guarantee any "residual value," that is, the bank's investment and profit less the sum of rentals collected over the term of the lease. (Parenthetically, I read the majority opinion as invalidating short-term lease transactions which make no provision for the lessee's guarantee of the chattel's residual value -- the so-called "closed-end lease" -- except where "the residual value of the leased property at the expiration of the lease contributes insubstantially to the bank's recovery of its advances plus interest." (Majority opinion at 12, my emphasis.))

The majority approves the former transaction (typically employed, in banker's jargon, in the financing of so-called "big ticket" items) because the lessor-bank, having recovered its investment over the term of the lease, assumes no risk not incidental to one aspect of the "business of banking": the "loaning of money on personal property" (12 U.S.C. § 24 (Seventh)), albeit cast in the form of a lease. Accordingly, I concur in that

part of the majority opinion holding that such transactions constitute the "business of banking" within the meaning of the statute. The bank recovers its advances plus interest in the form of rentals over the term of the lease, and the record indicates that as a matter of practice in such arrangements, the bank bears no risk of having to recover its investment by regaining possession of the chattel for the purpose of further realizing on its security.[1] I agree with the majority that such transactions are functionally indistinguishable from purchase money loans secured by a lienlike interest in the chattel.

The majority upholds the use of short-term leases, however -- typically employed in the "financing" of motor vehicles and like consumer items -- on the ground that in such transactions the bank looks to the credit-worthiness of the lessee to guarantee the anticipated resale value of personal property leased for a term less than that of its approximate economic life, thus freeing the bank of any obligation to realize further on the chattel by repeated leasings or comparable means of recovering its investment. The majority appears to reach this result by analogizing the bank's recovery and disposition of the chattel at the expiration of the lease to "the orderly liquidation of the bank's security . . . . " (Majority opinion at 11).

I agree, of course, with the proposition that a "lessor"-national bank may properly engage in functions incident to the orderly liquidation of its security. That is a traditional incident of the "business of banking" necessitated when any borrower defaults on a loan. But I do not regard that rule as in any way relevant to the present inquiry. In my view, the short-term lease arrangement entered into between the bank and the lessee contemplates at the outset that the bank will inevitably gain or regain possession of the subject matter of the so-called lease and that the amount reserved as rent does not reflect the full

value (or price) of the chattel plus interest. In such cases, the transaction is not, in my view, to be deemed one which constitutes the "business of banking" within the meaning of the statute. For in every such instance the fact is manifest that the bank itself will ultimately become the owner of the chattel.

In such a short-term lease transaction, it matters not whether the bank secures the guarantee of the lessee as to the residual value of the chattel at the expiration of the lease or must itself bear the risk of a downward fluctuation in value. On whomever the risk of a downward market falls, the bank as lessor must -- if the lessee himself does not agree to purchase the property[2] -- look to the market in the first instance in order to realize the full value of its investment. The majority concedes as much (at 7) in noting that "[s]hould the lessee not purchase the item . . . the lessor bank will dispose of it by sale or by way of a new lease." The bank is thus drawn ineluctably into the business of disposing of used chattels -- not in pursuit of the lender's traditional remedy of foreclosure and sale incident to the borrower's default -- but pursuant to the terms of the lease agreement itself. In my view, the resultant preordained participation of national banks in the market disposition of personal property is neither a part of the "business of banking" nor an incident thereto. I accordingly dissent from that part of the majority opinion holding short-term lease financing by national banks to be within the purview of 12 U.S.C. § 24 (Seventh).

FOOTNOTES

Page 2 1. Except, of course, in those distinguishable instances where the "lessee" defaults on its rental obligation under the terms of the lease agreement. See the discussion in the text, infra, at pp. 2-3.

Page 3 2. As the record in this case indicates, among the advantages offered the consumer by the motor vehicle lease transaction -- as advertised by the defendant banks -- are driving "top-of-the-line" new cars, no trade-in problems and few repairs. Such advantages would seem to accrue only where the consumer contemplates a relatively short-term (24 to 36 month) use of the vehicle and suggest that, realistically, the parties to the transaction envision from the outset that the bank will itself dispose of the vehicle at expiration of the lease by either offering it to the franchise dealer who generated the lease or wholesaling it to another dealer for resale.

APPENDIX B

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF WASHINGTON
AT SEATTLE

M & M LEASING CORPORATION, et al., Plaintiffs, vs. SEATTLE-FIRST NATIONAL BANK, et al., Defendants.	)	CIVIL NO. 508-73C2
M & M LEASING CORPORATION, et al., Plaintiffs, vs. PEOPLES NATIONAL BANK, et al., Defendants.	)	CIVIL NO. 509-73C2
	)	OPINION

These cases, consolidated for a nonjury trial before this Court, involve the legality under the National Bank Act, 12 U.S.C. § 24, of the motor vehicle leasing activities of national banks and their subsidiaries.

The plaintiffs, M & M Leasing Corporation; Goodway Leasing, Inc.; Bill Pierre Leasing, Inc.; and Budget Rent-a-Car of Washington-Oregon, Inc., are independent corporations engaged principally in motor vehicle leasing. Defendants Seattle-First National Bank (Seattle-First) and Peoples National Bank of Washington (Peoples) are engaged in the leasing of many products, including motor vehicles, either directly or through their respective subsidiaries, defendants Firstbank Leasing Corporation and Peoples Leasing Company. Defendant James E. Smith is Comptroller of the

Currency (Comptroller), whose office has authorized personal property leasing by national banks and their subsidiaries by interpretive rulings, 12 C.F.R. §§ 7.3400 and 7.7376.

The plaintiffs seek a declaration that the Comptroller's sanction of personal property leasing by national banks is invalid with respect to motor vehicle leasing because not authorized by 12 U.S.C. § 24 (Seventh). The plaintiffs also request an injunction barring defendant banks and their subsidiaries from further motor vehicle leasing activites. Even if the Comptroller's interpretive rulings are valid, plaintiffs argue that the defendant banks' activities have exceeded this authorization and should be enjoined to that extent.

The National Bank Act, 12 U.S.C. § 24 (Seventh), grants national banks the power

> "To exercise by its board of directors or duly authorized officers or agents, subject to law, all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes according to the provisions of this chapter . . . ."

The challenged Comptroller's interpretive ruling, 12 C.F.R. § 7.3400, states:

> "A national bank may become the owner or lessor of personal property acquired upon the specific request and for the use of a customer and may incur such additional obligations as may be incident to becoming an owner and lessor of such

> property. Lease transactions do not result in obligations for the purpose of 12 U.S.C. 84. Since the lease payments are in the nature of rent rather than interest, 12 U.S.C. 85 and 86 are not applicable."

Also involved is the interpretive ruling regarding operating subsidiaries, 12 C.F.R. § 7.7376, which states in part:

> "(a) General rule. With the prior approval of the Comptroller of the Currency, a national bank may engage in activities, which are a part of the business of banking or incidental thereto, by means of an operating subsidiary corporation. In order to qualify as an operating subsidiary hereunder, at least 80 percent of the voting stock of the subsidiary must be owned by the parent bank.
>
> "(b) Activities permitted. An operating subsidiary may perform any business function which the parent bank is permitted to perform. For example, through a bank department or an operating subsidiary, a national bank may issue credit cards, service mortgages, lease property, offer travel services, or operate a credit bureau."

Plaintiffs' principal contention is that the "business of banking" does not include motor vehicle leasing. Defendants claim that such leasing is in substance the equivalent of traditional loan financing, which always has been a banking function and therefore falls within the scope of bank activities permitted by 12 U.S.C. § 24 (Seventh).

FACTUAL BACKGROUND

In 1963 James J. Saxon, then Comptroller, issued the interpretive ruling, presently 12 C.F.R. § 7.3400, which authorizes the leasing of

personal property by national banks. Today there are at lest 650 national banks engaged in such leasing activity, with leases worth more than $2 billion. In addition, the state-chartered banks of forty states are authorized either by state statute or by administrative regulation to engage in personal property leasing, and the value of such leasing is about $1 billion. Much of bank leasing activity involves so-called "big ticket" items, such as aircraft and ships. Motor vehicle leasing by banks is a relatively recent phenomenon; for example, Peoples entered this field in February of 1972, Seattle-First in April of 1973.

Almost all of the denfendant banks' motor vehicle leases are dealer-generated leases.[1] Each bank has entered into agreements with many franchised automobile dealers whereby the bank agrees to purchase leases generated by the dealer. The dealer is usually free to lease vehicles under any conditions satisfactory to him. He concludes the lease transaction with the lease customer, makes delivery of the automobile, and then promptly assigns the lease paper to the bank. However, before a dealer-generated lease is accepted by the bank, the bank approves both the substantive terms of the lease and the credit-worthiness of the lessee. The bank requires a higher credit rating for a lease customer than it does for a customer who purchases an automobile with a substantial down payment and a time-payment contract. The bank pays the dealer an agreed price for the lease, generally purchasing the paper without recourse. The vehicle title application is completed with the bank as the legal owner and the customer as the registered owner and lessee. The bank notifies the lease customer that the lease has been assigned to the bank, and payments are made to the bank by the lessee throughout the life of the lease.

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[1] For ease of exposition, through this opinion "banks" is used when referring to either the banks or their subsidiaries.

A small number of the banks' automobile leases are direct leases, initiated by prospective lease customers who call at a bank and express the desire to lease a vehicle. The customer indicates the particular car and accessories which he desires to lease, and the bank determines whether the customer qualifies on a credit basis. If so, the customer is directed to select a car from a franchised dealer. After he has made his automobile selection, the bank acquires the vehicle by paying the dealer an agreed purchase price. The dealer then makes delivery directly to the lessee, and the lessee makes payments directly to the bank as agreed in the lease.

While practices and methods vary somewhat within the leasing business, generally there are two basic types of motor vehicle leases, "open-end" leases and "closed-end" leases. The "open-end" lease has the following general characteristics:

(1) The lease is usually for a term of from twenty-four to thirty-six months.

(2) The lessee assumes the risk of loss of, or damage to, the leased vehicle. Before he takes possession, the lessee is required to insure the automobie, naming the lessor as loss payee.

(3) The lessee assumes all responsibility for repair and maintenance of the leased vehicle.

(4) The lessee promises to make fixed monthly payments during the life of the lease and to make a final lump-sum payment at the end of the lease. This lump-sum amount, known as the guaranteed residual, is based upon a projection of the expected resale value of the leased vehicle, and it is anticipated that this payment will be produced from sale of the car. If it does not, the lessee pays the balance. If sale proceeds exceed the guaranteed residual, the excess is refunded to the lessee.

(5) The lease payments plus the guaranteed residual payment return to the lessor its original investment in the automobile (the purchase price), its cost of financing, all related overhead expenses, and a profit.

(6) The lessee does not have a specified option to purchase the vehicle at the conclusion of the lease period.

The "closed-end" lease differs from the open-end lease in one important detail: the lessee does not gurantee the residual value of the leased vehicle at the end of the lease; the lessor assumes that risk. Almost all of the motor vehicle leases held by defendant banks are open-end leases. However, the banks occasionally obtain some closed-end automobile leases when they purchase lease portfolios from independent leasing companies.[2] Also, many leases of big ticket items are closed-end, though often the lease term is calculated to span the usable life of the leased goods, leaving no residual value above salvage value.

One of three things ordinarily happens at the termination of an open-end lease. Although the lessee does not have the formal option to purchase the automobile, he may pay off the guaranteed residual himself, in which case the car is transferred to him or his designee. Otherwise, the automobile is offered to the franchised dealer from whom it was purchased. If the franchised dealer does not purchase the vehicle, the bank usually wholesales it to some other dealer, although occasionally the bank may lease the automobile again if it is not too old.

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[2] Often this purchase agreement contains a guarantee by the dealer of the vehicle residual values. In such cases the leases are essentially equivalent to open-end leases, the only difference being the identity of the residual value guarantor.

ANALYSIS

To assist the Court in resolving the dispute over the true nature of these motor vehicle lease transactions, plaintiffs emphasize the following facts:

First, the defendant banks use documents denominated "leases" in these transactions, and the terminology throughout the documents is that of bona fide lease agreements.

Second, the banks do not set out finance charges in these agreements. They do not comply with either the Truth in Lending Act, 15 U.S.C. § 1601, et seq., or the Retail Installment Sales Act, R.C.W. 63.14. The Comptroller's interpretive ruling itself, 12 C.F.R. § 7.3400, exempts personal property leases from certain limits imposed by Congress on interest charges and on the extent of loans to any one entity. Furthermore, the parties have stipulated in the pretrial order that the state usury statute does not encompass these transactions.

Third, no Washington state sales tax is paid by the lease customer on the original purchase of the automboile; instead, sales tax is paid on the monthly lease payments.

Finally, for tax accounting purposes, Seattle-First treats itself as the lessor of its leased motor vehicles, taking depreciation deductions and the investment tax credit. Peoples does not take these tax benefits in its motor vehicle leasing transactions, but both banks utilize these tax advantages in leases of big ticket items.[3]

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[3] See Lockhart Leasing Co. v. United States, 446 F.2d 269 (10th Cir. 1971); Rev. Rul. 55-540, 1955-2 Cum. Bull. 39.

These facts, though important considerations, are not determinative of the proper classification of these transactions. It is the substance, not the form, of the transactions which must govern. The difficulty with classifying motor vehicle leases as either bona fide leases or loan financing mechanisms is that, in this era of sophisticated financial relationships, there is no clear boundary between the two. Rather, there is a spectrum of financial relationships ranging from the unequivocal operating lease (such as the daily automobile rental) at one end to the traditional personal loan at the other end.

The defendant banks themselves conceive of vehicle leases as a species of legal chameleon: they resemble bona fide leases whenever resting upon a tax return or an interest disclosure form; yet they cannot be distinguished from ordinary loans when examined against the background of the National Bank Act.[4] Even though defendants receive seemingly inconsistent treatment from different governmental agencies, this Court is concerned only with the substance of these transactions within the context of the National Bank Act.

In my opinion, the open-end motor vehicle lease, which is the usual form, is merely a variation in the traditional manner of extending credit and is the functional equivalent of a loan

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[4] Defendants are not the first to assert semantic omnipotence.

"'When I use a word,' Humpty Dumpty said, in rather a scornful tone, 'it means just what I choose it to mean--neither more nor less.'

"'The questions is,' said Alice, 'whether you can make words mean so many different things.'

"'The question is,' said Humpty Dumpty, 'which is to be master--that's all.'" L. Carroll, Through the Looking-Glass 130 (St. Martin's Press 1968).

on personal security. Specifically, the open-end lease differs only insignificantly from a conditional sales contract with a final balloon payment. The lease customer assumes all of the burdens and risks of ownership of the automobile. The bank, during the lease term, is repaid the cost of the vehicle together with the cost of financing the transaction out of a combination of rentals and guaranteed residual payment, and sometimes tax benefits also. The bank is promised a pre-established financial return, with only the usual risks inherent in any credit transaction.

The closed-end vehicle lease, on the other hand, is not functionally equivalent to a loan because the lessee does not guarantee the residual value of the car. The risk of downward fluctuation in that value falls on the bank; this fact sets the closed-end vehicle lease apart from an ordinary loan. A closed-end lease is equivalent to a loan only if written for a term which exhausts the usable life of the leased property so that the bank does not rely on any residual value in its calculation of its expected financial return. Closed-end vehicle leases do not meet this criterion.

The conclusion that open-end vehicle leases, but not closed-end leases, as they are defined above, are equivalent to loan financing does not end our inquiry. Still remaining is the task of interpreting the National Bank Act, 12 U.S.C. § 24 (Seventh), to decide whether either lease type fits within the scope of authorized national bank activities.

At the outset it should be noted that the Comptroller's interpretation of the scope of this statute, while entitled to significant weight, is not dispositive. It is the function of the judiciary, not of an administrative agency, to ascertain finally the legitimate bounds of statutory authority. Barlow v. Collins, 397 U.S. 159 (1970).

Plaintiffs argue that the "business of banking" authorized by § 24 (Seventh) is limited to those functions which are expressly enumerated in the statute and those which are necessarily incidental to the enumerated functions. Since "leasing" is not found on the list of specific powers, plaintiffs contend that leasing is not a statutorily authorized national bank power. Plaintiffs rely heavily on Arnold Tours, Inc. v. Camp, 472 F.2d 427 (1st Cir. 1972), in which the First Circuit held that operation of travel agencies was outside the scope of § 24 (Seventh).

Defendants emphasize the wisdom of interpreting the statutory language, which dates back to 1864, with the flexibility necessary in order to allow national banks to maintain pace with modern developments in financial instruments and to serve the changing needs of their customers. Several decisions have indicated the desirability of such a flexible interpretation. See, e.g., Colorado National Bank v. Bedford, 310 U.S. 41 (1940); First National Bank v. National Exchange Bank, 92 U.S. 122 (1875).

It is unnecessary for this Court to resolve this conflict between two competing theories of statutory construction, for I conclude that open-end vehicle leases are authorized even by a narrow reading of the statute. The Arnold Tours opinion stated plaintiffs' position as follows, 472 F.2d at 432:

> "In our opinion, these decisions amply demonstrate that a national bank's activity is authorized as an incidental power, 'necessary to carry on the business of banking,' within the meaning of 12 U.S.C. § 24, Seventh, if it is convenient or useful in connection with the performance of one of the bank's established activities pursuant to its express powers under the National

> Bank Act. If this connection between an incidental activity and an express power does not exist, the activity is not authorized as an incidental power."

Elsewhere the court noted, 472 F.2d at 431:

> "The most reliable guides as to what is encompassed in the term 'the business of banking' are the express powers of national banks as set out in the National Bank Act. And when one looks at past decisions it becomes apparent that the activities of national banks which have been held to be permissible under the 'incidental powers' provision have been those which are directly related to one or another of a national bank's express powers."

It is clear from the foregoing analysis of the substance of the open-end vehicle lease that it is directly related to two of the national banks' express powers. Authorization for direct open-end leases is found in the grant of power of "loaning money on personal security." Dealer-generated open-end leases are directly related to the power of "discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt."

Closed-end vehicle leases, on the other hand, are not authorized by even an expansive reading of § 24 (Seventh). When a bank's financial return from a lease arrangement depends to any extent upon the residual value of the leased property, it has left the business of banking and entered the realm of speculative ventures.

Therefore, I conclude that the defendant banks are authorized by the National Bank Act to engage in open-end motor vehicle leasing activities. They are not empowered to engage in any closed-end lease transactions in which the banks

assume any risk of residual value fluctuations. The Comptroller's interpretive rulings are invalid only to the extent that they approve of such closed-end leases.

Plaintiffs' final argument is that, even if the Comptroller's rulings are valid, the defendant banks have exceeded the authority granted to them. Specifically, plaintiffs contend that the banks' solicitation of leasing business from the general public exceeds the Comptroller's approval of acquisition of personal property "upon the specific request and for the use of a customer." 12 C.F.R. § 7.3400. However, having found that open-end leasing is a power authorized by the National Bank Act, there is no logical or statutory basis for limiting a bank's use of the power by restricting its lessees to persons who utilize other services of the lessor bank.

This Opinion shall constitute findings of fact and conclusions of law. The Clerk is directed to file judgment accordingly.

DATED at Seattle, Washington, this 13th day of March, 1975.

/s/ Morell E. Sharp
UNITED STATES DISTRICT JUDGE

APPENDIX C

§ 24 Corporate powers of associations

Upon duly making and filing articles of association and an organization certificate a national banking association shall become, as from the date of the execution of its organization certificate, a body corporate, and as such, and in the name designated in the organization certificate, it shall have power--

First. To adopt and use a corporate seal.

Second. To have succession from February 25, 1927, or from the date of its organization if organized after February 25, 1927, until such time as it be dissolved by the act of its shareholders owning two-thirds of its stock, or until its franchise becomes forfeited by reason of violation of law, or until terminated by either a general or a special Act of Congress or until its affairs be placed in the hands of a receiver and finally wound up by him.

Third. To make contracts.

Fourth. To sue and be sued, complain and defend, in any court of law and equity, as fully as natural persons.

Fifth. To elect or appoint directors, and by its board of directors to appoint a president, vice president, cashier, and other officers, define their duties, require bonds of them and fix the penalty thereof, dismiss such officers or any of them at pleasure and appoint others to fill their places.

Sixth. To prescribe, by its board of directors, by-laws not inconsistent with law, regulating the manner in which its stock shall be transferred, its directors elected or appointed, its officers appointed, its property transferred, its general business conducted, and the privileges granted to it by law exercised and enjoyed.

Seventh. To exercise by its board of directors or duly authorized officers or agents, subject to law, all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes according to the provisions of this chapter. The business of dealing in securities and stock by the association shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the association shall not underwrite any issue of securities or stock: Provided, That the association may purchase for its own account investment securities under such limitations and restrictions as the Comptroller of the Currency may by regulation prescribe. In no event shall the total amount of the investment securities of any one obligor or maker, held by the association for its own account, exceed at any time 10 per centum of its capital stock actually paid in and unimpaired and 10 per centum of its unimpaired surplus fund, except that this limitation shall not require any association to dispose of any securities lawfully held by it on August 23, 1935. As used in this section the term "investment securities" shall mean marketable obligations, evidencing indebtedness of any person, copartnership, association, or corporation in the form of bonds, notes and/or debentures commonly known as investment securities under such further definition of the term "investment securities" as may by regulation be prescribed by the Comptroller of the Currency. Except as hereinafter provided or otherwise permitted by law, nothing herein contained shall authorize the purchase by the association of its own account of any shares of stock of any corporation. The limitations and restrictions herein contained as to dealing in, underwriting and purchasing for its own account, investment securities shall not

apply to obligations of the United States, or general obligations of any State or of any political subdivision thereof, or obligations of the Washington Metropolitan Area Transit Authority which are guaranteed by the Secretary of Transportation under section 9 of the National Capital Transportation Act of 1969, or obligations issued under authority of the Federal Farm Loan Act, as amended, or issued by the thirteen banks for cooperatives of any of them or the Federal Home Loan Banks, or obligations which are insured by the Secretary of Housing and Urban Development under title XI of the National Housing Act or obligations which are insured by the Secretary of Housing and Urban Development (hereafter in this sentence referred to as the "Secretary") pursuant to section 1713 of this title, if the debentures to be issued in payment of such insured obligations are guaranteed as to principal and interest by the United States, or obligations, participations, or other instruments of or issued by the Federal National Mortgage Association or the Government National Mortgage Association, or mortgages, obligations, or other securities which are or ever have been sold by the Federal Home Loan Mortgage Corporation pursuant to section 1454 or section 1455 of this title, or obligations of the Federal Financing Bank or obligations of the Environmental Financing Authority, or obligations or other instruments or securities of the Student Loan Marketing Association, or such obligations of any local public agency (as defined in section 1460(h) of Title 42) as are secured by an agreement between the local public agency and the Secretary in which the local agency agrees to borrow from said Secretary, and said Secretary agrees to lend to said local public agency, monies in an aggregate amount which (together with any other monies irrevocably committed to the payment of interest or such obligations) will suffice to pay, when due, the interest on and all installments (including the final installment) of the principal of such obligations, which monies under the terms of said agreement are required to

be used for such payments, or such obligations of a public housing agency (as defined in the United States Housing Act of 1937, as amended) as are secured (1) by an agreement between the public housing agency and the Secretary in which the public housing agency agrees to borrow from the Secretary, and the Secretary agrees to lend to the public housing agency, prior to the maturity of such obligations, monies in an amount which (together with any other monies irrevocably committed to the payment of interest on such obligations) will suffice to pay the principal of such obligations with interest to maturity thereon, which monies under the terms of said agreement are required to be used for the purpose of paying the principal of and the interest on such obligations at their maturity, (2) by a pledge of annual contributions under an annual contributions contract between such public housing agency and the Secretary if such contract shall contain the covenant by the Secretary which is authorized by section 1437(g) of Title 42, and if the maximum sum and the maximum period specified in such contract pursuant to section 1437(g) of Title 42 shall not be less than the annual amount and the period of payment which are requisite to provide for the payment when due of all installments of principal and interest on such obligations, or (3) by a pledge of both annual contributions under an annual contributions contract containing the covenant by the Secretary which is authorized by section 1437(g) of Title 42, and a loan under an agreement between the local public housing agency and the Secretary in which the public housing agency agrees to borrow from the Secretary, and the Secretary agrees to lend to the public housing agency, prior to the maturity of the obligations involved, moneys in an amount which (together with any other moneys irrevocably committed under the annual contributions contract to the payment of principal and interest on such obligations) will suffice to provide for the payment when due of all installments of principal and interest on such obligations, which moneys under the terms

of the agreement are required to be used for the purpose of paying the principal and interest on such obligations at their maturity: Provided, That in carrying on the business commonly known as the safe-deposit business the association shall not invest in the capital stock of a corporation organized under the law of any State to conduct a safe-deposit business in an amount in excess of 15 per centum of the capital stock of the association actually paid in and unimpaired and 15 per centum of its unimpaired surplus. The limitations and restrictions herein contained as to dealing in and underwriting investment securities shall not apply to obligations issued by the International Bank for Reconstruction and Development, the Inter-American Development Bank or the Asian Development Bank, or obligations issued by any State or political subdivision for housing, university, or dormitory purposes, which are at the time eligible for purchase by a national bank for its own account, nor to bonds, notes and other obligations issued by the Tennessee Valley Authority or by the United States Postal Service: Provided, That no association shall hold obligations, issued by any of said organizations as a result of underwriting, dealing, or purchasing for its own account (and for this purpose obligations as to which it is under commitment shall be deemed to be held by it) in a total amount exceeding at any one time 10 per centum of its capital stock actually paid in and unimpaired and 10 per centum of its unimpaired surplus fund. Notwithstanding any other provision in this paragraph, the association may purchase for its own account shares of stock issued by a corporation authorized to be created pursuant to sections 3931 to 3940 of Title 42, and may make investments in a partnership, limited partnership, or joint venture formed pursuant to section 3937(a) or 3937(c) of Title 42. Notwithstanding any other provision of this paragraph, the association may purchase for its own account shares of stock issued by any State housing corporation incorporated in the State in which the association is located and may make

investments in loans and commitments for loans to any such corporation: Provided, That in no event shall the total amount of such stock held for its own account and such investments in loans and commitments made by the association exceed at any time 5 per centum of its capital stock actually paid in and unimpaired plus 5 per centum of its unimpaired surplus fund. Notwithstanding any other provision in this paragraph, the association may purchase for its own account shares of stock issued by a corporation organized solely for the purpose of making loans to farmers and ranchers for agricultural purposes, including the breeding, raising, fattening, or marketing of livestock. However, unless the association owns at least 80 per centum of the stock of such agricultural credit corporation the amount invested by the association at any one time in the stock of such corporation shall not exceed 20 per centum of the unimpaired capital and surplus of the association.

Eighth. To contribute to community funds, or to charitable, philanthropic, or benevolent instrumentalities conducive to public welfare, such sums as its board of directors may deem expedient and in the interests of the association, if it is located in a State the laws of which do not expressly prohibit State banking institutions from contributing to such funds or instrumentalities. R.S. § 5136; July 1, 1922, c. 257, § 1, 42 Stat. 767; Feb. 25, 1927, c. 191, § 2, 44 Stat. 1226; June 16, 1933, c. 89, § 16, 48 Stat. 184; Aug. 23, 1935, c. 614, § 308, 49 Stat. 709; Feb. 3, 1938, c. 13, § 13, 52 Stat. 26; June 11, 1940, c. 301, 54 Stat. 261.

Ninth. To issue and sell securities which are guaranteed pursuant to section 1721(g) of this title.

12 C.F.R. 7.3400:

"A national bank may become the owner or lessor of personal property acquired upon the

specific request and for the use of a customer and may incur such additional obligations as may be incident to becoming an owner and lessor of such property. Lease transactions do not result in obligations for the purpose of 12 U.S.C. 84. Since lease payments are in the nature of rent rather than interest, 12 U.S.C. 85 and 86 are not applicable.

12 C.F.R. 7.7376:

"(a) General Rule.

"With the prior approval of the Comptroller of the Currency, a national bank may engage in activities which are a part of the business of banking or incidental thereto, by means of an operating subsidiary corporation. In order to qualify as an operating subsidiary hereunder, at least eighty percent (80%) of the voting stock of the subsidiary must be owned by the parent bank.

"(b) Activities Permitted.

"An operating subsidiary may perform any business function which the parent bank is permitted to perform. For example, through a bank department or an operating subsidiary, a national bank may issue credit cards, service mortgages, lease property, offer travel services, or operate a credit bureau.[6]

Figure 16
ANALYSIS OF BALANCE SHEET CHANGES
Average Balances

$ Millions	1977	Increase (Decrease) Amt.	%
Commercial Loans	$1,927	$269	16
Real Estate Loans	644	117	22
Installment and Other	697	144	26
Total Loans	$3,268	$530	19
Taxable Securities	147	(27)	(15
Tax-Free Securities	353	(4)	(1
Total Investment Securities	$ 500	$(31)	(6
Trading Account Securities	30	(21)	(40
Funds Sold	618	46	8
* Lease Financing	162	64	66
TOTAL EARNING ASSETS	$4,578	$588	15
Other Assets	897	118	15
TOTAL ASSETS	$5,475	$706	15

X D

	1976	Increase (Decrease) Amt.	%	1975	1974	1973
	$1,658	$ 88	6	$1,570	$1,416	$1,152
	527	11	2	516	469	372
	553	111	25	442	396	359
	$2,738	$210	8	$2,528	$2,281	$1,883
)	174	22	14	152	159	168
)	357	45	15	312	354	345
)	$ 531	$ 67	14	$ 464	$ 513	$ 513
)	51	18	53	33	17	13
	572	(25)	(4)	597	649	585
	98	43	77	55	31	13
	$3,990	$313	9	$3,677	$3,491	$3,007
	779	57	8	722	640	543
	$4,769	$370	8	$4,399	$4,131	$3,550

Figure 16 (Continued)
ANALYSIS OF BALANCE SHEET CHANGES
Average Balances

$ Millions	1977	Increas (Decreas Amt.	
Demand Deposits	$1,474	$188	
Savings and Savings Bonds	1,779	339	
CD's and Other Time	534	(103)	(
Foreign Deposits	411	64	
TOTAL DEPOSITS	$4,198	$488	
Funds Borrowed	690	140	
Long-Term Debt	60	25	
Other Liabilities	243	27	
Shareholders' Equity	284	26	
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$5,475	$706	

se se) %	1976	Increase (Decrease) Amt.	%	1975	1974	1973
15	$1,286	$124	11	$1,162	$1,062	$1,002
24	1,440	278	24	1,162	1,027	944
16)	636	(195)	(23)	831	675	410
18	348	(10)	(3)	358	354	265
13	$3,710	$197	6	$3,513	$3,118	$2,621
25	550	66	14	484	690	642
72	35	35	--	--	--	--
12	216	47	27	169	114	91
10	258	25	11	233	209	196
15	$4,769	370	8	$4,399	$4,131	$3,550